

## **18. Farmers and creative artists**

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### **18.1 Introduction and key definitions**

#### **18.1.1 Farming**

Farming is defined in the *Income Tax Act 2007* as “the occupation of land wholly or mainly for the purposes of husbandry”. This includes hop growing. It also includes the breeding and rearing of horses, and the grazing of horses in connection with those activities.

The cultivation of short rotation coppice is regarded as husbandry, not as forestry. Short rotation coppice is defined as:

“a perennial crop of tree species planted at high density, the stems of which are harvested above ground level at intervals of less than 10 years”.

For an activity to be within the definition of farming, the produce of the activity must have some husbandry origin in the land occupied by the person undertaking said activity. This means that intensive enterprises, where livestock are kept entirely separate from the land and fed entirely on purchased feed, are not considered farming under the statutory definition.

#### **Market gardening**

The definition of farming does not include market gardening, which itself is defined as:

“the occupation of land as a garden or nursery for the purpose of growing produce for sale”.

**Law:** ITA 2007, s. 996

**Guidance:** BIM 55105

#### **18.1.2 Farming trades**

Regardless of whether the land is managed on a commercial basis and with a view to profit, farming or market gardening in the UK is treated as the carrying on of a trade or part of a trade for income tax purposes.

Further, all farming in the UK carried on by a person (other than farming carried on as part of another trade) is treated for income tax purposes as one trade.

## ***Farming overseas***

The automatic treatment of farming as a trade is restricted to land farmed within the UK.

Where husbandry is conducted on land outside the UK, such activity is not automatically deemed to be a trade. Instead, whether the activity constitutes trading is determined according to ordinary principles.

## ***Market gardening***

All market gardening in the UK is treated as the carrying on of a trade or part of a trade. While market gardeners can access the averaging provisions (see **18.1.3**) they are also subject to the rules that may restrict loss relief (see **18.2**).

**Law:** ITTOIA 2005, s. 9, 859

**Guidance:** BIM 55051, 62600

### ***18.1.3 Averaging relief for farmers***

Farming is an industry where profits can fluctuate markedly from year to year. To counteract this, farmers and market gardeners carrying on their trade in the UK may decide to claim averaging relief, which is designed to “smooth out” profits over a period of either two or five years.

Note that the intensive rearing in the UK of livestock or fish on a commercial basis for the production of food for human consumption, while outside the statutory definition of farming (see **18.1.1**), does qualify for averaging relief.

#### ***Two-year averaging***

Two-year averaging relief is available in relation to two consecutive tax years where:

- the relevant profits of one of the tax years are less than 75% of the relevant profits of the other tax year; or
- the relevant profits of one (but not both) of the tax years are nil.

#### ***Five-year averaging***

Five-year averaging relief is available in relation to five consecutive tax years where a “volatility test” is met, whereby:

- one of the following is less than 75% of the other:
  - the average of the relevant profits of the first four tax years to which the claim relates; or
  - the relevant profits of the last of the tax years to which the claim relates; or
- the relevant profits of one or more (but not all) of the five tax years to which the claim relates are nil.

When considering relevant profits for the purposes of two and five-year averaging, transition profits arising in 2023-24 as a result of the transitional rules towards a tax year basis of taxation are ignored. See **15.4-15.6** for further discussion.

### ***Calculating average profits***

For the purposes of two-year or five-year averaging relief, profit is taken to mean profits after capital allowances and balancing charges, and after any adjustment made under ITTOIA 2005, Pt. 2, Ch. 16ZA for compensation for the compulsory slaughter of animals. Profits for averaging relief purposes are also taken to mean profits before making any deduction for a loss made in any tax year.

If a taxpayer makes a loss in a tax year, the relevant profits of that year are taken to be nil. Note that the taxpayer can still take advantage of loss relief provisions (see **Chapter 17**).

If a profit of a tax year has already been averaged, the figure to use in a later calculation is the averaged profit, not the actual result for the year.

### ***Making the claim***

Typically, a claim for averaging relief (whether two-year or five-year) must be made on or before the first anniversary of the normal self-assessment filing date for the last of the tax years to which the claim relates. So, a claim for averaging in the 2023-24 tax year should be made by 31 January 2026.

Sole traders should claim averaging relief in Box 72 of the self-employment (full) pages.

Partners should claim averaging relief in Box 11 of their partnership pages. Note that each individual partner in a partnership can make a personal choice as to whether to claim averaging relief, irrespective of what the other partners do.

Averaging does not affect the amount of tax or NICs that a taxpayer pays in earlier years – adjustments for years relating to an averaging claim are taken into account in the later tax year.

### ***Restrictions***

Averaging relief is available to sole traders and individual partners in partnership. It is not available to companies, including corporate partners in a partnership.

An averaging claim cannot be made in relation to a tax year in which the taxpayer starts, or permanently ceases, to carry on the trade.

Averaging relief is not available for taxpayers who use the cash basis to calculate their profit or loss.

### **Example 1 – two-year averaging**

Priti's trading profits are £20,000 in 2022-23 and £10,000 in 2023-24.

As the trading profits in 2023-24 satisfy the 75% test, two-year averaging is available. Where averaging is claimed, the profit for each tax year is deemed to be as follows:

$$(\pounds20,000 + \pounds10,000) / 2 = \pounds15,000$$

This means that Priti has a £5,000 increase in profit in 2023-24. This increase should be reported in Box 72 of the self-employment (full) pages of her return.

Note that the above example holds, even if Priti's trading profit of £20,000 in 2022-23 was the result of an averaging claim for 2022-23 and 2021-22.

### **Example 2 – five-year averaging**

Paul has the following trading profits:

	<b>£</b>
2023-24	50,000
2022-23	30,000
2021-22	10,000
2020-21	20,000
2019-20	15,000

The average trading profit for the four tax years 2019-20 to 2022-23 is £18,750, being  $(£30,000 + £10,000 + £20,000 + £15,000) / 4$ .

As this average trading profit of £18,750 satisfies the volatility test when compared to the £50,000 trading profit in 2023-24, five-year averaging is available. Where averaging is claimed, the profit for each tax year is deemed to be as follows:

$$(\pounds50,000 + \pounds30,000 + \pounds10,000 + \pounds20,000 + \pounds15,000) / 5 = \pounds25,000.$$

This means that Paul has a £25,000 decrease in profit in 2023-24. This decrease should be reported in Box 72 of the self-employment (full) pages of his return.

As a five-year averaging claim has been made, Paul should also work out the overall increase/decrease in his tax and Class 4 NICs for 2019-20 to 2022-23 as a result of the averaging claim, and report the adjustment in the tax calculation summary pages of his 2023-24 return. Box 14 is used to report an increase in tax due, and box 15 to report a decrease.

**Law:** ITTOIA 2005, s. 221-225; FA 2022, Sch. 1, para. 74

**Guidance:** *Helpsheet 224: Farmers and market gardeners*; BIM 84000

#### **18.1.4 The herd basis election**

As a general rule, farm animals are treated as trading stock.

However, farmers who keep a “production herd” for the purposes of their trade may elect for the herd basis to apply. The herd basis effectively treats a herd or flock of production animals as akin to a capital asset in most circumstances and excludes them from trading stock.

A production herd is defined in the legislation as:

“a herd of animals of the same species (irrespective of breed) kept by the farmer wholly or mainly for the products obtainable from the living animal which the animals produce for the farmer to sell”.

“Products obtainable from the living animal” means the young of the animal, or any other product obtainable from the animal without slaughtering it (e.g. milk, eggs).

This means that some animals are excluded from the herd basis, whether by falling outside the above definition, or by way of specific exclusion. Examples of excluded animals include working animals, and animals kept primarily for fattening or slaughter.

Broadly, the effects of a herd basis election are that:

- The specified herd is not treated as trading stock, and so no deduction is allowed for the initial cost of the herd, nor for the cost of any subsequent increase in herd size.
- In calculating the profits of the trade, the value of the herd is not brought into account.
- The net cost of replacing animals in the herd is an allowable deduction.
- Where a few animals from the herd are sold and are not replaced, the profit/loss arising is brought into account as a receipt/deduction respectively.
- Where the whole or a substantial part of the herd is sold and not replaced, the profit/loss arising is not brought into account as a receipt/deduction.

The above is a high-level summary only, and other legislative provisions may apply depending on the situation. HMRC's guidance at BIM 55515 provides a useful summary of which rule to apply depending on the farmer's circumstances.

For the herd basis to apply, an election must be made in writing. The election should specify the class of production herd to which it relates, and separate elections may be made where there are different classes of production herds. The election is irrevocable.

Generally, for sole traders and partnerships, the election should be made within 12 months after the normal self-assessment filing date for the tax year which contains the end of the first period of account in which the farmer/partnership keeps a production herd of the specified class.

### **Example – time limit for claim**

Isla, a sole trader, begins to keep an eligible production herd in June 2022. She prepares her accounts annually to 31 December.

Isla should make a herd basis election by 31 January 2026, being 12 months after the self-assessment filing date for her 2023-24 self-assessment tax return.

The election can be made by a sole trader, partnership, or a company. Where farming is carried on in partnership, a herd basis election is made at the partnership level. Any change to the membership of the partnership requires a new herd basis election.

Note that the herd basis rules do not apply where the farmer uses the cash basis.

**Law:** ITTOIA 2005, s. 111-129

**Guidance:** BIM 55500, 55515